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In the

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1944.

No. 1205.

THOMAS M. STUBBS, AS TRUSTEE IN BANKRUPTCY OF AMERICAN BOND & SHARE CORPORATION,

PETITIONER,

v.

FULTON NATIONAL BANK OF ATLANTA,

RESPONDENT.

PETITION FOR WRIT OF CERTIORARI.

CLARENCE H. CALHOUN,
MADISON RICHARDSON,
WILLIAM A. SUTHERLAND,
Attorneys for Petitioner.

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To the Honorable, the Supreme Court of the United States:

Thomas M. Stubbs as Trustee in Bankruptcy of American Bond & Share Corporation respectfully prays for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Fifth Circuit entered in the above entitled cause. Petitioner is hereinafter referred to as "Trustee," American Bond & Share Corporation as "bankrupt" and Respondent as "Bank."

OPINION BELOW.

The opinion of the Circuit Court of Appeals was rendered on January 6, 1945, and is reported at 146 F. (2d) 556.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered January 6, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925. The time for filing this petition was extended to April 26, 1945 by order of this Court entered March 30, 1945.

QUESTION PRESENTED.

Where a corporation, for the purpose of inducing the public to make deposits for investment, falsely claims to have realized enormous earnings for its depositors, and where a national bank, which assists in financing the operations of the corporation, knows of said claims and the purpose for which they are made, and admittedly suspects their falsity—does the Bank thereby have notice of the intent of such corporation to defraud such depositors; or may the Bank accept such false statements of earnings as legitimate "puffing" or "seller's talk"?

STATUTES INVOLVED.

The Trustee sues under Section 70 (e) of the Bankruptcy Act as amended, 11 U. S. C. A., Sec. 110 (e):

> "The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of the adjudication.

Such property may be recovered or its value collected from whoever may have received it, except a bona fide holder for value."

The Georgia Fraudulent Conveyance Act[1] (Georgia Code of 1933, Section 28-201) provides:

"***Enumeration of void acts.*** The following acts by debtors shall be fraudulent in law against creditors and others, and as to them null and void, viz.:

. . . . . .

"2. Every conveyance of real or personal estate . . . had or made with intention to delay or defraud creditors, and such intention known to the party taking. A bona fide transaction on a valuable consideration, and without notice or ground for reasonable suspicion, shall be valid."

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In failing to hold that the Trustee was entitled to recover from the Bank for each of the transfers here involved because said transfers were fraudulent conveyances and void under the law of Georgia;

2. In holding that a false claim of enormous past earnings by a corporation inviting deposits from the public,

[1] That the fraudulent conveyances condemned by Section 70 (e) are conveyances fraudulent under State law is well settled. *Stellwagen v. Crum*, 245 U. S. 605, 614; *Anderson v. Gray*, 284 F. 770 (4) (CCA 5th); *Irving Trust Co. v. Finance Service Co.*, 63 F. (2d) 694 (CCA 2d); *Hale v. Hummel*, 64 F. (2d) 210, 212 (CCA 8th).

The Georgia law of fraudulent conveyances is based upon the statute of 13th Elizabeth. Practically all the States either treat that statute as part of the common law, or have adopted statutes more or less similar to the statute of 13th Elizabeth. 37 C. J. S., p. 852, Sec. 2.

which a large national bank, assisting in financing the corporation's operations, suspects to be false, may be accepted by the Bank as legitimate "puffing" or "seller's talk" so as not to constitute notice of fraud;

3. In holding that notice to a large national bank of the falsity of a claim of enormous past earnings for depositors, made by a corporation for the purpose of inducing deposits with it, does not, in and of itself, constitute notice of intended fraud upon the corporation's depositors, but may be accepted by the bank as legitimate "puffing" or "seller's talk";

4. In holding in effect that a false claim of enormous past earnings for its depositors, made by a corporation for the purpose of inducing deposits with it, does not, in and of itself, constitute fraud, but is permissible as "puffing" or "seller's talk" if the corporation is prospering and the amount of the earnings is merely "exaggerated".

STATEMENT OF THE CASE.

The error complained of in this petition is a pure error of law. No analysis of evidence as to disputed facts is necessary to a consideration of the errors assigned. The statement of facts here made is of undisputed facts which are appropriate to give the Court a proper background for the consideration of this single question of law.

This is a suit by a Trustee in Bankruptcy under Section 70 (e) of the Bankruptcy Act of 1898, as amended, to recover from the Bank the value of securities transferred by the bankrupt to the Bank in fraud of its creditors to secure six separate loans made by the Bank upon bankrupt's

securities,[2] to enable bankrupt to finance its operations, including the payment of certain large debts.

Bankrupt conducted a swindle of the familiar Ponzi type. It solicited deposits from the public, repayable on demand, allegedly for use in honest speculation on the customers' behalf, upon the false representation that Bradley, its president, possessed great experience and that it had had extraordinary success in trading in securities and commodities (R. 440-442). Such trading in securities as it in fact did was comparatively small and resulted in losses, not profits (R. 96, par. 10; 107). But, following the Ponzi technique, bankrupt made to every depositor, every month, down to the time of its collapse, a handsome payment falsely represented as his participation in "earnings", and employed deposits from subsequent depositors to pay "earnings" to earlier depositors (R. 209, 584-585). The larger part of the funds deposited with bankrupt did not go into speculation at all, but went to satisfy such payments to depositors of fictitious "earnings", to carry heavy overhead, and into substantial embezzlements by bankrupt's president, Bradley (R. 107, 132-133, 405).

The Securities and Exchange Commission began an in-

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[2] The dates of transfer, the value of securities transferred and the loans made by the Bank were as follows:

Date of Transfer	Value of Securities	Amount of Loan
December 21, 1933	$ 73,000.00	$ 55,000.00
January 9, 1934	50,000.00	40,000.00
January 25, 1934	12,000.00	8,000.00
April 24, 1934	6,000.00 (and securities not here involved)	5,255.62
May 19, 1934	15,000.00	9,357.60
June 1, 1934	4,500.00	2,684.50
(Date unknown)	10,000.00	.....
	$170,500.00	$120,297.82

vestigation early in 1935,[3] whereupon Bradley, bankrupt's president, fled; was later apprehended; pleaded guilty to using the mails to defraud, and was sent to the penitentiary (R. 133). Between January, 1933 and March, 1935, when it collapsed, bankrupt had received deposits from many hundreds of persons aggregating over half a million dollars, all except a trivial portion of which had been dissipated at the time of its collapse (R. 213).

The Court below apparently assumed the foregoing facts,[4] which were not in dispute, and considered that the sole issue was whether the Bank, which had paid value for the transfers to it, could establish that it took without notice[5] of the transferor's intent to defraud its depositors so as to be entitled to protection as a bona fide purchaser. The Court below held that the required notice was lacking

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[3] Bankrupt's deposit contracts, entitling customers to participate in the profits of its trading operations, constitute a "security" under the Securities Act of 1933, 15 U. S. C. A., Sec. 77 (b) (1) (R. 96, 279-280).

[4] Actually the opinion of the Court below nowhere states the fraud in which the bankrupt was engaged, although the sole issue in the case was that of fraudulent conveyance, intended fraud in the conveyance being the primary fact to be determined before the question of notice could arise. It seems most unusual that the Court should have attempted to consider the question of notice of fraud without any statement of the facts of fraud.

[5] *In the Court below nothing turned upon any distinction between "knowledge," or "notice" or "ground for reasonable suspicion" upon the port of the Bank; and we, therefore, use the terms herein interchangeably.* As the Court below apparently recognized, it is clear under the Georgia Fraudulent Conveyance Act (p. 3, supra) that "either notice, or grounds for reasonable suspicion, will be treated as equivalent to knowledge." *Palmour v. Johnson,* 84 Ga. 91, 99. The usual statement of the rule is that if the transfer is made to defraud, it is void if the transferee had "knowledge of such intention or reasonable grounds to suspect the same." *Dickson v. Citizens Bank & Trust Co.,* 184 Ga. 398 (2); *Hilburn v. Hightower,* 178 Ga. 534 (1); *Killebrew v. Smith,* 182 Ga. 117, 118; *Cunningham v. Avakian,* 192 Ga. 391 (1).

as to every transfer.[6] In considering the error in this holding, on which alone this petition for certiorari is based, it is not necessary to refer to the mass of undisputed evidence of suspicious circumstances that came to the Bank's knowledge.[7] It is sufficient for present purposes that the Court below found that the Bank's officers knew that the bankrupt was making claims of enormous earnings for past depositors for the purpose of inducing deposits from the public, and that the Bank admittedly suspected the falsity of such representations (R. 980). The error herein complained of is that the Court drew the erroneous legal conclusion that notice of these facts did not constitute notice of the intended fraud.

Knowledge of bankrupt's claims of enormous past earnings for depositors had come to the Bank, before any of the transfers, in a letter from bankrupt to the Bank dated September 8, 1933 (copied as Appendix A hereto, p. 17, infra) urging the Bank to desist from warning persons, inquiring of the Bank, not to deal with bankrupt, but on the contrary to represent to such persons that the Bank had knowledge that bankrupt was unusually successful and, to support this request, the bankrupt set out in the letter a statement of amounts which it claimed to have *"earned and paid"* to depositors each month since it began business in the preceding January. This statement from the letter follows:

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[6] The District Court had found notice as to the fifth and sixth transfers only (R. 417-418). The Master had found notice as to all of the transfers except the first. The Master's holding of no notice as to the first transfer was based expressly upon the ground that the Bank's president entertained a mistaken view of the law at the time of the first transfer which prevented it from having notice of bankrupt's fraudulent intention as to that transfer (R. 139).

[7] The important evidence on this point is summarized in Appendix B, p. 20, infra, should the Court be interested for any reason in considering it.

1933	Net Percentage Paid
January	20.24
February	10.12
March	14.72
April	17.02
May	11.04
June	10.58
July	6.44
August	8.28
Average per month over a period of eight months	12.30½

The Trustee assumed that where false representations of its past earnings were made by bankrupt to induce the public to invest, such false representations were necessarily fraudulent as to such investors; and further, that the Bank, if it had notice of the falsity of such representations, necessarily had notice of bankrupt's intended fraud upon such investors. However, the Court below—while finding that the Bank had notice that such representations were "exaggerated"—held that the Bank did not have notice of bankrupt's intended fraud; and this, for the reason that such "exaggeration," in the opinion of the Court below, amounted to no more than legitimate "puffing" or "seller's talk" (R. 980).[8]

The Court entirely ignored the fact that the statements made were of ascertainable facts and that the earnings were stated in odd and varying percentages per month, carried out to one one-hundredth (1/100th) of one percent (1%), to cause them to have the appearance of meticulously accurate statements of fact. The Court analogized such false or "exaggerated" claims to the unduly en-

[8] The Court euphemistically referred to the claims as "exaggerated," carefully avoiding the terms "false" or "fraudulent" (R. 980-981).

thusiastic claims of advertisers by press and radio for the quality or value of their commodities or services, as though the bankrupt had been proclaiming the superior virtues of a shaving cream or a beauty parlor or the value—not cost —of an alarm clock.

The key paragraph of the opinion is quoted in full:

> "*It is true that Bradley in a letter dated September 8, 1933, made claims to extravagant profits covering his dealings in the market over the months from January through August of that year. The bank officials admitted frankly that they suspected these claims to be* EXAGGERATED, but they testified that no one ever suspected or suggested that Bradley was engaged in fraudulent activities or that the transfers were made for the purpose of defrauding creditors. The bank made a rather thorough investigation which resulted in no information constituting a ground for suspicion. The bankrupt's main place of business was in Atlanta; it had hundreds of depositors, and at and during the time loans were made by the bank all depositors seemed satisfied; no complaints against Bradley or the bankrupt appear from the record; and Bradley, according to the record, enjoyed the general confidence of the community. Under these *favorable circumstances* it was natural for the bank to look upon his claim of earnings, *though* EXAGGERATED, as evidencing that the business carried on by him was prospering. *It is common practice for a seller to* EXAGGERATE *the value of his wares, and extravagant claims for a commodity or for a service offered to the public for sale occur daily through the press and over the radio; almost all who read and hear them know them to be exaggerated, but few, if any, associate the* EXAGGERATION *with fraud*" (R. 980-981). (Emphasis supplied.)

In the foregoing paragraph and elsewhere in its opinion the Court points out circumstances which it terms "favorable" to the Bank. Such "favorable" circumstances would

be of importance if, but only if, they *removed* the Bank's suspicion. Yet nowhere does the Court find or even intimate that the suspicion, which the Bank admittedly entertained, as to the falsity of bankrupt's claims of enormous earnings, was removed or in any degree lessened by these "favorable" circumstances.[9]

REASONS FOR GRANTING THE WRIT.

This petition for certiorari relies solely upon the error of law underlying the holding of the Court below that the Bank, in accepting the transfers in question, had no notice of bankrupt's intention to defraud its depositors.[10] The decision of the Court below is based squarely upon that Court's legal conclusion that notice to the Bank that bankrupt was soliciting from the public investment of funds on the basis of false statements of past earnings does not charge the Bank with notice of any intended fraud on the part of the bankrupt, but that such "exaggerated" statements may be accepted by the Bank as legitimate "puffing" or "seller's talk."

As a matter of logical necessity there is implicit in this

[9] Most of the evidence in the possession of the Bank, in addition to the letter claiming enormous earnings, was *highly unfavorable* to bankrupt (see Appendix B, p. 20, infra). The Court below, in making findings as to notice independent of and at variance with the master's findings (see footnote 6, p. 7, supra), has completely ignored important evidence including noteworthy omissions of the Bank to produce material evidence in its possession, and has construed as not unfavorable other evidence which clearly is unfavorable to bankrupt.

[10] While counsel for the Bank urged a number of defenses in the Court below, other than absence of notice to the Bank of any intent on bankrupt's part to defraud its creditors—and may attempt to urge such defenses here—such other questions are entirely unimportant in the consideration of this petition for certiorari which is directed to the single error on which the decision of the Court below was based. If any such other defenses have any merit, as we do not believe, they can be considered on the hearing of the case on the merits.

holding the assumption that the corporation making such solicitations on the basis of such "exaggerated" statements of earnings is not thereby guilty of intent to defraud, but is indulging only in legitimate "puffing" or "seller's talk"; because, as is entirely clear, if a bank, hearing such false statement of earnings and suspecting it to be exaggerated, might nevertheless accept such statement as legitimate "puffing" or "seller's talk", the corporation knowingly making such exaggerated statement would not thereby be guilty of fraud. When this assumption which is implicit in the Court's decision is made explicit, the shocking nature of the decision of the Court below is immediately apparent and the propriety of granting the writ for the reasons stated below becomes readily apparent.

I. The Holding of the Court Below Is in Conflict With the Decisions of Other Circuit Courts of Appeal and Contrary to the Accepted Principles Underlying the Law of Fraud.

The decision of the Court below holding that a wilfully false statement of past earnings made to induce investment with the declarant is not fraud is in clear conflict with decisions of the Seventh and Eighth Circuits, under the Securities Act of 1933, holding that a false representation of past earnings or of financial condition, made to induce investments by the public, constitutes fraud. *Securities & Exchange Com. v. Universal Service Assn.*, 106 F. (2d) 232, 235 (CCA 7th); *Holmes v. United States*, 134 F. (2d) 125, 128 (CCA 8th).

The Court's decision is also in conflict with decisions in the Eighth and Ninth Circuits holding that the circulation through the mails to prospective customers of false statements as to earnings realized by a corporation constitutes

proof of the use of the mails to defraud. *Foshay v. United States*, 68 F. (2d) 205, 207 (CCA 8th); *Stephens v. United States*, 41 F. (2d) 440, 442 (CCA 9th).

These Circuit Court of Appeals decisions are in entire accord with the well-settled law of Georgia,[11] the Supreme Court of Georgia having uniformly held that a false representation of a corporation's financial condition or its physical assets, made to induce a sale of corporate stock, is a fraud upon the purchaser. *Huson Ice & Coal Co. v. Thornton*, 143 Ga. 297, 299; *Howard v. Allgood*, 143 Ga. 550; *Williams v. Fouche*, 164 Ga. 311 (5-b), and *Castleberry v. Wells*, 183 Ga. 328, 334 (expressly holding that a false statement by a corporation of its financial condition, made to induce contributions from existing stockholders, is not to be treated as "puffing" or "trade talk," but constitutes a fraud).

The error of the Court below arises apparently from its failure to recognize a very vital distinction, fundamental in the law of fraud, between a statement of opinion and a statement of fact. The distinction is illustrated in a simple example under Section 474 of the *Restatement of the Law of Contracts*, as follows:

> "4. A induces B to contract to buy goods by stating that they had cost him $1,000.00. The statement is false, as A knows. It is fraud. Though statements of *value* are ordinarily statements of opinion, statements of *cost* are not." (Emphasis supplied.)

Exactly the same principle which applies to a false statement of cost applies also to a false statement of past earn-

[11] The Georgia law of course governs, but the Georgia law is in keeping with the general law of fraud. The only material difference in the Georgia law of fraudulent conveyances is that "ground for reasonable suspicion" is equivalent to "knowledge." (See footnote 5, p. 6, supra.)

ings, more especially when stated on a monthly basis and carried out to one one-hundredth (1/100th) of one (1) per cent so as to give the appearance of meticulous accuracy. Such a statement is of a definitely ascertainable fact. If it is knowingly false, and made with intent to deceive, it is clear fraud; and the Bank, or anyone having notice that such statement is false and that it is made with intent to deceive, has notice of the intended fraud. If, "as the Bank may have assumed",[12] bankrupt actually had been prospering and had been only "exaggerating" the amounts of its earnings, the statement nevertheless would obviously have constituted fraud. In the above example from the Restatement of the Law of Contracts, the misstatement of the cost of goods would in the usual case be only an "exaggeration."

Nor is it necessary, in order to charge the Bank with notice of an intent on the part of bankrupt to defraud bankrupt's depositors, that the Bank should have had notice of the whole scope of bankrupt's fraudulent scheme, or that bankrupt was insolvent, or that bankrupt was making no profits, but was losing large sums of money. It is not necessary that the Bank should have known anything other than that bankrupt was soliciting deposits from the public for investment upon claims of earnings as to the falsity of which the Bank had notice.

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[12] In the paragraph of the opinion quoted at p. 9, supra, the Court below stated that it was natural for the Bank to look upon bankrupt's claims of enormous earnings, "though exaggerated," as evidencing that the business carried on by bankrupt was prospering. Even if such a belief would have excused the Bank—as it clearly would not—it is difficult to understand how a national bank can be assumed to have construed a false statement of fantastic earnings as evidencing that the declarant is enjoying prosperity.

II. **The Holding of the Court Below Is of Great Public Importance in Connection With Securities Transactions and the Liability of Banks Financing Fraudulent Enterprises.**

At a time when the whole tendency of legislation and judicial decision is to impose a stricter and stricter duty, not only of honesty but of full disclosure, upon persons inviting investments from the public, a decision of a Circuit Court of Appeals which sanctions as legitimate "puffing" or "seller's talk," "exaggerated" statements of past earnings made for the purpose of inducing investments by the public, or which condones a large national bank in treating such statements as legitimate "puffing" or "seller's talk" although it admittedly suspects their falsity, is of great public importance in a vital field of the law.

It is of the utmost importance that there be no misunderstanding in the financial world that a corporation's willful "exaggeration" of its past earnings is not a statement of opinion, but is the statement of a fact; that it is not permissible "puffing" or "seller's talk," but is obvious fraud.

It is of great public importance also that a bank should not be permitted with impunity to lend its resources and prestige to one engaged in a scheme of securing deposits from the public on a basis of "exaggerated" claims of earnings, where, as here, the bank has knowledge of such claims and actually suspects their falsity. Banks enjoy great privileges and exercise tremendous power. With this power should certainly go the responsibility of not accepting fraudulent transfers from persons whom the bank knows to be soliciting funds from the public upon the basis of false and fraudulent statements as to past earnings. The decision of the Court below could not fail to encourage banks in the unhealthy belief that they owe no responsibility to the investing public for the fraudulent character

of the enterprises which they finance, even when the bank has notice of the intended fraud of such borrowers upon the public.

Petitioner, of course, does not contend that there is any duty upon a bank, which has no notice of intended fraud of a prospective borrower, to make any investigation in that regard. However, when the bank is in possession of knowledge of facts which clearly put it on notice of the borrower's intended fraud upon his creditors, it is of the utmost public importance that the bank should not be encouraged to believe that it can show the callous disregard of the public interest which obviously accompanied the making of the present loans. Mr. Clay, the president of the Bank, when being questioned as to his suspicions concerning bankrupt's claims of enormous earnings, which officers of the Bank admittedly suspected to be false, testified (R. 894):

> "The only thing I paid any attention to was the value of the collateral. I wasn't concerned with whether he was making a profit for his clients or not. That was his clients' business, and not mine."

CONCLUSION.

Petitioner submits that the certiorari should be granted and the decision below reversed for the reasons above stated.

Respectfully submitted,

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